

CITY OF LITCHFIELD, MICHIGAN
FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT
YEAR ENDED JUNE 30, 2006

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Litchfield	County Hillsdale
Fiscal Year End 6/30/06	Opinion Date 10/5/06	Date Audit Report Submitted to State 11/15/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

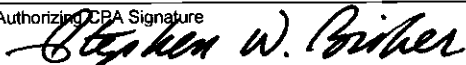
YES NO

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☒ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☒ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Osbourne, March, Condon & Co., P.C.		Telephone Number 517.439.9331	
Street Address 184 W. Carleton Road		City Hillsdale	State MI
Zip 49242			
Authorizing CPA Signature 		Printed Name Stephen W. Bisher	
License Number 1101026492			

CITY OF LITCHFIELD, MICHIGAN

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Osbourne, March, Condon & Co., P.C.

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INDEPENDENT AUDITOR'S REPORT

To the City Council
City of Litchfield, Michigan
Litchfield, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Litchfield, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the Litchfield Fire Department, a joint venture between the City of Litchfield, Michigan and Litchfield Township, Michigan, which the financial statements reflect the City's total share of assets and revenues constituting one percent of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Litchfield Fire Department, a joint venture between the City of Litchfield, Michigan and Litchfield Township, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Litchfield, Michigan, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 5, 2006 on our consideration of City of Litchfield, Michigan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of the audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis and the budgetary comparisons information on pages iii through viii and 30 through 33 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the method of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Osbourne, March, Condon & Co P.C.

Certified Public Accountants

Hillsdale, Michigan
October 5, 2006

Management's Discussion and Analysis
Year Ended June 30, 2006

The following discussion and analysis of the financial performance for the City of Litchfield (the "City") provides an overview of the City's financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the City's financial statements.

Financial Highlights

The following represents the most significant financial highlights for the year ended June 30, 2006:

- Property taxes are the City's single, largest source of revenue. The City's tax base, net of captured taxable value, for fiscal year 2006 was \$26,124,773 which represents an increase of \$1,330,573 or 5.4 percent over fiscal year 2005.
- State shared revenue, the second largest revenue source was reduced by the State of Michigan by approximately \$1,200 this year. This represents a less than 1 percent decrease from the prior year.
- Act 51 monies, received from gasoline tax through the State of Michigan, the third largest revenue source, decreased by approximately \$1,380 this year. This represents a 1.3 percent decrease from the prior year.
- The City's largest expense for fiscal year 2006 was general governmental activities at \$313,400.

Using the Annual Report

This annual report consists of a series of financial statements. The statement of net assets and the statement of activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. This longer-term view uses the accrual basis of accounting so that it can measure the cost of providing services during the current year, and whether the taxpayers have funded the full cost of providing government services.

The fund financial statements present a short-term view; they tell us how the taxpayers' resources were spent during the year, as well as how much is available for future spending. Fund financial statements also report the City's operations in more detail than the government-wide financial statements.

Management's Discussion and Analysis
Year Ended June 30, 2006

The City as a Whole

The following table shows, in a condensed format, the net assets as of the current year in comparison to the prior year:

	Governmental Activities		Business-type Activities	
	2006	2005	2006	2005
Current assets	\$ 667,755	\$ 640,388	\$ 1,508,502	\$ 1,372,415
Capital assets	1,296,885	1,319,841	2,221,423	2,371,984
Other noncurrent assets	33,090	33,778		
Total Assets	<u>\$ 1,997,730</u>	<u>\$ 1,994,007</u>	<u>\$ 3,729,925</u>	<u>\$ 3,744,399</u>
Current liabilities	\$ 68,295	\$ 66,725	\$ 129,969	\$ 123,789
Long-term liabilities	43,210	37,160	795,000	915,000
Total Liabilities	<u>\$ 111,505</u>	<u>\$ 103,885</u>	<u>\$ 924,969</u>	<u>\$ 1,038,789</u>
Net Assets:				
Invested in capital - net of related debt	\$ 1,296,885	\$ 1,303,230	\$ 1,306,423	\$ 1,336,834
Restricted	7,517	35,209	73,428	209,028
Unrestricted	581,823	551,683	1,425,105	1,159,748
Total Net Assets	<u>\$ 1,886,225</u>	<u>\$ 1,890,122</u>	<u>\$ 2,804,956</u>	<u>\$ 2,705,610</u>
Total Net Assets and Liabilities	<u>\$ 1,997,730</u>	<u>\$ 1,994,007</u>	<u>\$ 3,729,925</u>	<u>\$ 3,744,399</u>

The City's combined net assets increased by approximately 2 percent from a year ago – increasing from \$4.6 million to \$4.7 million.

Total assets of governmental activities increased less than 1 percent or \$3,700. This is a net result of total current assets increasing \$27,400, total capital assets decreasing \$23,000 and total other noncurrent assets decreasing \$700. The increase in current assets in the amount of \$27,400 is primarily due to the City allocating these current resources to fund future street projects. The decrease in total capital assets is due to depreciation. The decrease in total other noncurrent assets is primarily due to Litchfield Fire Department's expenditures exceeding revenues for FYE 2006, thereby reducing cash assets held in the joint venture with Litchfield Township for fire services.

Total assets for business type activities decreased less than 1 percent by \$14,400. This is a net result of total current assets increasing \$136,000 and total noncurrent assets decreasing \$150,500. The current asset increase is due to a contribution from Litchfield TIFA for maintenance and replacement of future infrastructure. The total noncurrent assets decrease of \$150,500 is due to assets fully depreciating.

CITY OF LITCHFIELD, MICHIGAN

Management's Discussion and Analysis
Year Ended June 30, 2006

The following is the government-wide results of operations for the current fiscal year in comparison to prior year:

	Governmental Activities <u>2006</u>	Business-type Activities <u>2006</u>	Governmental Activities <u>2005</u>	Business-type Activities <u>2005</u>
Revenue				
Program Revenue:				
Charges for services	\$ 55,765	\$ 318,381	\$ 74,430	\$ 326,235
Operating grants and contributions	178,262	161,582	206,715	150,602
Capital grants and contributions	9,092		6,945	
General Revenue:				
Property taxes	366,798		368,155	
State-shared revenues	137,289		138,535	
Interest	27,807	59,935	13,137	19,655
Other				
Lease revenue	5,385		5,385	
Transfers in	55,300		48,800	
Transfers out		(49,300)		(46,800)
Total Revenue	<u>\$ 835,698</u>	<u>\$ 490,598</u>	<u>\$ 862,102</u>	<u>\$ 449,692</u>
Program Expenses				
General government	\$ 313,468	\$	\$ 281,335	\$
Public safety	281,608		233,165	
Highways and street	66,210		51,241	
Public works	66,424		92,355	
Parks and recreation	84,243		58,557	
Depreciation (unallocated)	41,854		33,169	
Water		147,727		149,398
Sewer		197,595		177,027
Refuse		45,930		45,395
	<u>\$ 853,807</u>	<u>\$ 391,252</u>	<u>\$ 749,822</u>	<u>\$ 371,820</u>
	<u>\$ (18,109)</u>	<u>\$ 99,346</u>	<u>\$ 112,280</u>	<u>\$ 77,872</u>

Total governmental activities expenses increased 13.8 percent or \$104,000 as a result of the following reasons: public safety expenses increased \$48,000 due to increases in police expenditures of \$31,000 primarily due to payroll and benefit increases and fire services of \$17,000 in part due to hazardous material revenues being shared from a previous year, general government expenses increased \$32,000 primarily due to State Tax Commission decisions reducing taxable value of previous year's property tax liability, and parks and recreation expenses increased \$25,000 primarily due to renovations at the City pool to make it handicap accessible.

Total business type activities expenses increased 5.2 percent due primarily to a \$20,000 increase in sewer funds expenses. There were increases in sewer expenses for lines maintenance to televise sewer mains for possible problem areas, other expenses to clean up sewer backup damage, equipment for sewer by-pass pumping and D.O. meter, payroll for increased maintenance frequency on sewer lift stations, and rent to store sewer inventory.

Expenses for component units increased \$438,000 as a result of the Tax Increment Financing Authority's development in the industrial park and housing project for anticipated community growth. The cost to develop the residential housing is anticipated to be off set in part by the sale of lots, therefore the cost was capitalized. Industrial park development expenses are not anticipated to be off set by any sales, consequently the development cost was considered expense.

Management's Discussion and Analysis
Year Ended June 30, 2006

A decrease in operating grants and contributions in the amount of \$28,400 is due to the public charitable contributions made to the municipal pool refinishing project in the previous year.

Total general revenues increased 3.2 percent by \$18,500 primarily due to the market offering a better rate of interest on the City of Litchfield's investments.

Governmental Activities

In fiscal year 2006, there were revenue decreases experienced 1) in charges for services due to the cemetery contract ending with Litchfield Township, 2) in operating grants and contributions due to public charitable contributions for the pool refinishing project received in the previous year, 3) in property taxes due to penalties for delinquent property taxes being paid to TIFA instead of City since no delinquent taxes are owed to City, and 4) in state revenues due to a cut in state shared revenues. These losses of revenue were offset by a decrease in cemetery expenses with maintenance on cemeteries outside of the City now handled by Litchfield Township and an increase in the City's tax base and charges for internal services. The increase in property tax base is a result of inflationary increases in existing parcels. There has been no increase in the operating millage rate. The City millage rate continues at 13 mills.

Net assets was reduced in general governmental activities for contributions received in 2005 for pool renovations expenses incurred in 2006 and for State Tax Commission and Tribunal reductions on prior year taxable values.

Business-type Activities

The City's business-type activities consist of the Water, Sewer and Solid Waste Funds. The City operates both Water and Sewer facilities. The Solid Waste Fund includes refuse/recycling collection and brush and leaf pickup. Refuse collection and recycling services are provided by an outside commercial entity. Brush and leaf pickup service is provided by the City of Litchfield's Public Works department.

Charges for services in the Water, Sewer and Solid Waste Collection operations decreased by 2.4 percent, primarily due to the decline in water consumption by the community. This is attributable to the slow housing market creating many vacant houses. Operating grants and contributions increased by 7.3 percent due to grant revenues received for wellhead capping program completion. Expense increased by 5.2 percent primarily due to the cleanup of sewage backups and televising of the sewer lines to check for possible problem areas.

The City's Funds

The City's fund financial statements follow the government-wide financial statements. The fund financial statements provide detailed information about the significant funds, not the City as a whole. The City Council creates funds to help manage money for specific purposes as well as to show accountability for certain activities. The City's major governmental funds for 2006 include the General Fund, Major Street Fund, Local Street Fund and Recreation Fund. The City's major proprietary funds include the Water Fund, Sewer Fund and Solid Waste Fund.

Management's Discussion and Analysis
Year Ended June 30, 2006

General Fund Highlights

The General Fund accounts for all police, fire, public works, planning and zoning, and administrative functions of the City government. The budget is essentially a "maintenance" budget, which means it increases modestly from year to year. The budget is monitored closely and amended periodically. The result is that actual revenues and expenses are usually within 5 percent of budgeted amounts.

The General Fund pays for most of the City's governmental services. The most significant are general governmental activities, which incurred expenses of approximately \$313,000 in 2006. Expenses for general government are recorded in the "general" department within the General Fund.

Capital Asset and Debt Administration

At the end of fiscal year 2006, the City had approximately \$3,550,000 (net of depreciation) invested in a broad range of capital assets, including buildings, police and fire equipment, public works equipment, and water and sewer facilities. There is no related infrastructure reported in the year end net capital investment. The City elected to follow the method of prospective reporting of infrastructure assets provided in the GASB 34 reporting pronouncement.

The City continues to pay down debt obligations related to capital investments. Outstanding revenue bonds, for the construction of sewer facilities, reported in the Sewer Fund in the amount of \$795,000 represents 79.3 percent of the City's total liabilities at June 30, 2006. Historically, the City's Tax Increment Financing Authority has contributed \$150,000 annually towards the repayment of the debt.

The City also funds equipment replacements by setting aside cash in the General Fund and maintains an Equipment Fund. The Equipment Fund charges City departments for the use of equipment. Monies collected accumulate towards the replacement of equipment. The City properly maintains existing equipment and carefully plans for equipment replacements to avoid burdening taxpayers with additional debt millage to replace existing equipment.

Economic Factors and Next Year's Budgets and Rates

The general operating millage will not be increased for next year, despite no projected increase in State-shared revenue. Certain expenditures are assumed to continue beyond the rate of inflation, such as health care insurance and liability insurance. Salary and benefits for the City Manager is expected to increase 51% however, contributions from the Tax Increment Finance Authority for economic development services are anticipated to offset this increase.

A new cemetery agreement with Litchfield Township allowing City residents to be buried at Mt. Hope cemetery for a fee to the City citizen equal to what a Township citizen would pay is currently being negotiated. If accepted by both parties, the agreement will require the City of Litchfield to pay Litchfield Township a fee of \$800 per City resident who is buried at Mt. Hope retroactive to July 1, 2005. The result would increase the City's expenses significantly in the next fiscal year. Approximately 10 City residents are buried in Mt. Hope cemetery per year.

Maintenance on the City building consisting of replacing exterior entry doors and installing awnings will increase expenses in building maintenance approximately \$10,000.

Brush and leaf pickup expense will be moved to the solid waste collection fund thereby decreasing expenses in general fund and increasing expense in the solid waste collection fund approximately \$20,000.

Economic Factors and Next Year's Budgets and Rates (concluded)

Street maintenance will increase approximately \$50,000 primarily to overlay Williams street and curb the corners.

Maintenance of the sewer system to continue the cleaning and televising of sewer mains/man holes and overhaul of one lift station pump will increase sewer expenses approximately \$13,000.

In August 2006, City Council accepted a bid of \$131,650 for a fixed network radio frequency meter reading system (Gallaxy) and all new residential, commercial and industrial meters. This technology will allow the City to read water/sewer meters from the city office and detect meter tampering, leaks and potential meter problems through system reports. Installation will begin in the fall of 2006. The cost of the new system and meters will be split between water and sewer.

Preventative maintenance on one well or pump in water fund will increase expenses by \$15,000.

There were no significant variances between budget and actual results.

Contacting the City's Management

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report, or need additional information, or would like to obtain financial statements of the City's component units, Tax Increment Finance Authority (TIFA) or Downtown Development Authority (DDA), we welcome you to contact the City's Administrative office located at 221 Jonesville Street, Litchfield, Michigan 49252.

CITY OF LITCHFIELD, MICHIGAN
GOVERNMENT-WIDE FINANCIAL STATEMENTS
STATEMENT OF NET ASSETS
JUNE 30, 2006

	PRIMARY GOVERNMENT			
	GOVERNMENTAL	BUSINESS	ELIMINATION	TOTAL
	ACTIVITIES	ACTIVITIES	OF INTERNAL	
			BALANCES	
ASSETS				
Current Assets:				
Cash	\$ 617,032	\$ 1,433,359	\$	\$ 2,050,391
Investments				5,169
Accounts receivable	515	4,654		16,340
Interest receivable	839	15,501		5,000
Note receivable, current portion	5,000			
Land contract receivable, current portion				44,369
Due from other governmental units	44,369			
Internal balances		34,215	(34,215)	20,773
Inventory		20,773		
Total Current Assets	\$ 667,755	\$ 1,508,502	\$ (34,215)	\$ 2,142,042
Noncurrent Assets:				
Note receivable, net of current portion	\$ 2,500	\$	\$	\$ 2,500
Land contract receivable, net of current portion				30,590
Investment in joint venture	30,590			
Investment in land				
Infrastructure development				7,846,319
Capital assets	1,842,692	6,003,627		(4,328,011)
Accumulated depreciation	(545,807)	(3,782,204)		
Total Noncurrent Assets	\$ 1,329,975	\$ 2,221,423	\$	\$ 3,551,398
TOTAL ASSETS	\$ 1,997,730	\$ 3,729,925	\$ (34,215)	\$ 5,693,440
LIABILITIES AND NET ASSETS				
Current Liabilities:				
Accounts payable	\$ 15,519	\$ 2,091	\$	\$ 17,610
Long-term debt, current portion		120,000		120,000
Accrued liabilities	18,561	3,303		21,864
Accrued interest		4,575		4,575
Due to other governmental units				
Internal balances	34,215		(34,215)	
Total Current Liabilities	\$ 68,295	\$ 129,969	\$ (34,215)	\$ 164,049
Noncurrent Liabilities:				
Compensated absences, net of current portion	\$ 43,210	\$	\$	\$ 43,210
Long-term debt, net of current portion		795,000		795,000
Total Noncurrent Liabilities	\$ 43,210	\$ 795,000	\$	\$ 838,210
Total Liabilities	\$ 111,505	\$ 924,969	\$ (34,215)	\$ 1,002,259
Net Assets:				
Invested in capital assets, net of related debt	\$ 1,296,885	\$ 1,306,423	\$	\$ 2,603,308
Restricted for bond repayment		73,428		73,428
Restricted for police training	1,217			1,217
Restricted for personal property tax audit	6,300			6,300
Unrestricted	581,823	1,425,105		2,006,928
Total Net Assets	\$ 1,886,225	\$ 2,804,956	\$	\$ 4,691,181
TOTAL LIABILITIES AND NET ASSETS	\$ 1,997,730	\$ 3,729,925	\$ (34,215)	\$ 5,693,440

See accompanying notes to the basic financial statements.

COMPONENT UNITS	
TAX INCREMENT FINANCING AUTHORITY	DOWNTOWN DEVELOPMENT AUTHORITY
\$ 1,207,755	\$ 7,995
607,651	
277	
17,678	
54,798	1,000
64,756	
<u>\$ 1,952,915</u>	<u>\$ 8,995</u>
\$ 522,183	\$ 5,253
189,793	
809,339	
350,000	
(50,400)	
<u>\$ 1,820,915</u>	<u>\$ 5,253</u>
<u>\$ 3,773,830</u>	<u>\$ 14,248</u>
\$ 48,756	\$ 1,000
150,000	
<u>\$ 198,756</u>	<u>\$ 1,000</u>
\$	\$ 5,388
\$	\$ 5,388
\$ 198,756	\$ 6,388
\$ 299,600	\$
<u>3,275,474</u>	<u>7,860</u>
<u>\$ 3,575,074</u>	<u>\$ 7,860</u>
<u>\$ 3,773,830</u>	<u>\$ 14,248</u>

CITY OF LITCHFIELD, MICHIGAN
GOVERNMENT-WIDE FINANCIAL STATEMENTS
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2006

	EXPENSES	PROGRAM REVENUES		
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS
PRIMARY GOVERNMENT				
Governmental Activities:				
General government	\$ (313,468)	\$ 34,178	\$ 28,300	\$ 6,792
Public safety	(281,608)	2,520	26,056	
Highways and streets	(66,210)		121,972	
Public works	(66,424)	351		
Parks and recreation	(84,243)	18,716	1,934	2,300
Depreciation (unallocated) - excludes direct depreciation expense	(41,854)			
Total Governmental Activities	<u>\$ (853,807)</u>	<u>\$ 55,765</u>	<u>\$ 178,262</u>	<u>\$ 9,092</u>
Business-type Activities:				
Sewer Fund	\$ (197,595)	\$ 104,383	\$ 150,000	\$
Water Fund	(147,727)	163,116	11,582	
Refuse Fund	(45,930)	50,882		
Total Business-type Activities	<u>\$ (391,252)</u>	<u>\$ 318,381</u>	<u>\$ 161,582</u>	<u>\$</u>
TOTAL PRIMARY GOVERNMENT	<u>\$ (1,245,059)</u>	<u>\$ 374,146</u>	<u>\$ 339,844</u>	<u>\$ 9,092</u>
COMPONENT UNITS				
Tax Increment Finance Authority	\$ (713,990)	\$	\$ 1,000	\$
Downtown Development Authority	(2,751)			
TOTAL COMPONENT UNITS	<u>\$ (716,741)</u>	<u>\$</u>	<u>\$ 1,000</u>	<u>\$</u>
GENERAL REVENUES				
Property taxes				
State-shared revenues				
Interest				
Lease revenue				
Other				
Transfers				
TOTAL GENERAL REVENUES				
CHANGE IN NET ASSETS				
NET ASSETS - BEGINNING OF YEAR				
PRIOR PERIOD ADJUSTMENT				
NET ASSETS - BEGINNING OF YEAR, RESTATED				
NET ASSETS - END OF YEAR				

See accompanying notes to the basic financial statements.

NET (EXPENSE) REVENUE AND CHANGES IN NET ASSETS				
PRIMARY GOVERNMENT			COMPONENT UNITS	
GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTAL	TAX INCREMENT FINANCING AUTHORITY	DOWNTOWN DEVELOPMENT AUTHORITY
\$ (244,198)	\$	\$ (244,198)	\$	\$
(253,032)		(253,032)		
55,762		55,762		
(66,073)		(66,073)		
(61,293)		(61,293)		
(41,854)		(41,854)		
\$ (610,688)	\$	\$ (610,688)	\$	\$
\$	\$ 56,788	\$ 56,788	\$	\$
	26,971	26,971		
	4,952	4,952		
\$	\$ 88,711	\$ 88,711	\$	\$
\$ (610,688)	\$ 88,711	\$ (521,977)	\$	\$
\$	\$	\$	\$ (713,990)	\$ (1,751)
\$	\$	\$	\$ (713,990)	\$ (1,751)
\$ 366,798	\$	\$ 366,798	\$ 564,056	\$ 1,633
137,289		137,289		
27,807	59,935	87,742	105,324	15
5,385		5,385		
55,300	(49,300)	6,000	33,000	370
\$ 592,579	\$ 10,635	\$ 603,214	\$ 702,380	\$ 2,018
\$ (18,109)	\$ 99,346	\$ 81,237	\$ (11,610)	\$ 267
1,890,122	2,705,610	4,595,732	\$ 3,586,684	\$ 7,593
14,212		14,212		
\$ 1,904,334	\$ 2,705,610	\$ 4,609,944	\$ 3,586,684	\$ 7,593
\$ 1,886,225	\$ 2,804,956	\$ 4,691,181	\$ 3,575,074	\$ 7,860

CITY OF LITCHFIELD, MICHIGAN
BALANCE SHEET - GOVERNMENTAL FUNDS

JUNE 30, 2006

	MAJOR FUNDS				TOTAL GOVERNMENTAL FUNDS
	GENERAL	MAJOR STREET	LOCAL STREET	RECREATION	
ASSETS					
Cash	\$ 233,916	\$ 260,119	\$ 42,427	\$ 3,304	\$ 539,766
Accounts receivable	325				325
Interest receivable		666			666
Due from other governmental units	26,128	13,762	4,479		44,369
Due from other funds			2,129		2,129
Prepaid expense					
TOTAL ASSETS	<u>\$ 260,369</u>	<u>\$ 274,547</u>	<u>\$ 49,035</u>	<u>\$ 3,304</u>	<u>\$ 587,255</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 4,550	\$ 288	\$ 7,789	\$ 2,704	\$ 15,331
Accrued liabilities	13,753	337	149	3,672	17,911
Due to other funds		2,129			2,129
Total Liabilities	<u>\$ 18,303</u>	<u>\$ 2,754</u>	<u>\$ 7,938</u>	<u>\$ 6,376</u>	<u>\$ 35,371</u>
Fund Balances:					
Reserved for:					
Police training - state funding	\$ 1,217	\$	\$	\$	\$ 1,217
Donor restricted	6,300				6,300
Board designated	46,011				46,011
Unreserved, undesignated	188,538	271,793	41,097	(3,072)	498,356
Total Fund Balances (Deficits)	<u>\$ 242,066</u>	<u>\$ 271,793</u>	<u>\$ 41,097</u>	<u>\$ (3,072)</u>	<u>\$ 551,884</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 260,369</u>	<u>\$ 274,547</u>	<u>\$ 49,035</u>	<u>\$ 3,304</u>	<u>\$ 587,255</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
WITH THE STATEMENT OF NET ASSETS

YEAR ENDED JUNE 30, 2006

GOVERNMENTAL FUND BALANCE		\$ 551,884
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources, and are not reported in the funds		
The cost of capital assets is	\$ 1,600,433	
Accumulated depreciation is	<u>(410,144)</u>	1,190,289
Receivables are expected to be collected in future years and are not available to pay for current year expenditures		7,690
Long-term liabilities are not due and payable in the current period and are not reported in the funds		
Compensated absences		(43,210)
Internal Service Funds are also included as governmental activities to the extent of activity occurring between governmental funds and the Internal Service Fund		
Assets:		
Cash	\$ 77,266	
Interest receivable	173	
The cost of the capital assets is	242,259	
Accumulated depreciation is	<u>(135,663)</u>	184,035
Liabilities:		
Payables	(838)	
Internal balance	<u>(34,215)</u>	(35,053)
Investments in joint ventures are included as part of governmental activities		<u>30,590</u>
NET ASSETS OF GOVERNMENTAL ACTIVITIES		<u>\$ 1,886,225</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES -

GOVERNMENTAL FUNDS

YEAR ENDED JUNE 30, 2006

	MAJOR FUNDS				TOTAL GOVERNMENTAL FUNDS
	GENERAL	MAJOR STREET	LOCAL STREET	RECREATION	
REVENUES					
Taxes	\$ 366,798	\$	\$	\$	\$ 366,798
State shared revenues	138,345	5,367			143,712
State gasoline tax revenue		81,868	27,129		108,997
State grant	6,792	5,168			11,960
Charges for services	25,232			18,716	43,948
Licenses and permits	9,503				9,503
Fines, fees, and forfeits	1,781				1,781
Community contributions		2,440		4,234	6,674
Component unit contributions	53,300				53,300
Interest	17,990	8,596	1,175	46	27,807
Lease revenue	5,385				5,385
Other	5,884				5,884
TOTAL REVENUES	\$ 631,010	\$ 103,439	\$ 28,304	\$ 22,996	\$ 785,749
EXPENDITURES					
General government	\$ 308,827	\$	\$	\$	\$ 308,827
Public safety	267,548				267,548
Highways and streets		34,657	32,426		67,083
Public works	66,060				66,060
Parks and recreation	20,421			64,578	84,999
Debt service:					
Principal	16,611				16,611
Interest	970				970
Capital outlay	14,312			4,289	18,601
TOTAL EXPENDITURES	\$ 694,749	\$ 34,657	\$ 32,426	\$ 68,867	\$ 830,699
REVENUES OVER (UNDER) EXPENDITURES	\$ (63,739)	\$ 68,782	\$ (4,122)	\$ (45,871)	\$ (44,950)
OTHER FINANCING SOURCES (USES):					
Operating transfers in	\$ 66,500	\$	\$ 8,251	\$ 42,983	\$ 117,734
Operating transfers out	(42,983)	(16,251)	(2,000)	(1,200)	(62,434)
TOTAL OTHER FINANCING SOURCES (USES)	\$ 23,517	\$ (16,251)	\$ 6,251	\$ 41,783	\$ 55,300
NET CHANGE IN FUND BALANCE	\$ (40,222)	\$ 52,531	\$ 2,129	\$ (4,088)	\$ 10,350
FUND BALANCES - BEGINNING	282,288	219,262	38,968	1,016	541,534
FUND BALANCES (DEFICITS) - END OF YEAR	\$ 242,066	\$ 271,793	\$ 41,097	\$ (3,072)	\$ 551,884

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2006

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS	\$ 10,350
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures, and in the statement of activities these costs are allocated over their estimated useful lives as depreciation:	
Depreciation expense	\$ (41,854)
Capital outlay	<u>15,727</u>
	(26,127)
Net loss from joint venture is not recorded in the governmental funds, but is recorded in the statement of activities	(9,900)
Repayment of capital leases is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt)	16,611
Decreases in accumulated employee sick and vacation pay are recorded when incurred in the statement of activities	(6,051)
Internal Service Funds are also included as governmental activities to the extent of activity occurring between governmental funds and the Internal Service Fund	2,359
Included in governmental activities is an expenditure for the forgiveness of the current amount due from a local industrial corporation on a long-term note receivable. Where as, governmental funds recognize revenue and expenditures when cash is either collected or disbursed	(5,000)
Cash collections on delinquent sidewalk receivables are included in the governmental funds, but are not included in revenues in the governmental activities	<u>(351)</u>
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u>\$ (18,109)</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

PROPRIETARY FUNDS

STATEMENT OF NET ASSETS

JUNE 30, 2006

	ENTERPRISE FUNDS	
	MAJOR FUND	
	SEWER	WATER
ASSETS		
Current Assets:		
Cash	\$ 1,024,597	\$ 405,717
Accounts receivables	940	935
Interest receivable	13,258	2,243
Inventory		20,773
Total Current Assets	<u>\$ 1,038,795</u>	<u>\$ 429,668</u>
Noncurrent Assets:		
Capital assets	\$ 4,216,987	\$ 1,786,640
Accumulated depreciation	(2,844,876)	(937,328)
Total Noncurrent Assets	<u>\$ 1,372,111</u>	<u>\$ 849,312</u>
TOTAL ASSETS	<u><u>\$ 2,410,906</u></u>	<u><u>\$ 1,278,980</u></u>
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Long-term debt, current portion	\$ 120,000	\$
Accounts payable	831	1,046
Accrued liabilities	992	2,311
Accrued Interest	4,575	
Total Current Liabilities	<u>\$ 126,398</u>	<u>\$ 3,357</u>
Noncurrent Liabilities:		
Long-term debt, net of current portion	<u>\$ 795,000</u>	<u>\$</u>
Total Liabilities	<u>\$ 921,398</u>	<u>\$ 3,357</u>
Net Assets:		
Invested in capital assets, net of related debt	\$ 457,111	\$ 849,312
Restricted for bond repayment	73,428	
Unrestricted	958,969	426,311
Total Net Assets	<u>\$ 1,489,508</u>	<u>\$ 1,275,623</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 2,410,906</u></u>	<u><u>\$ 1,278,980</u></u>

See accompanying notes to the basic financial statements.

ENTERPRISE FUNDS		INTERNAL SERVICE FUND
NON- MAJOR FUND		
REFUSE	TOTAL	EQUIPMENT
\$ 3,045	\$ 1,433,359	\$ 77,266
2,779	4,654	
	15,501	173
	20,773	
\$ 5,824	\$ 1,474,287	\$ 77,439
\$	\$ 6,003,627	\$ 242,259
	(3,782,204)	(135,663)
\$	\$ 2,221,423	\$ 106,596
\$ 5,824	\$ 3,695,710	\$ 184,035
\$	\$ 120,000	\$
214	2,091	188
	3,303	650
	4,575	
\$ 214	\$ 129,969	\$ 838
\$	\$ 795,000	\$
\$ 214	\$ 924,969	\$ 838
\$	\$ 1,306,423	\$
5,610	73,428	
	1,390,890	183,197
\$ 5,610	\$ 2,770,741	\$ 183,197
\$ 5,824	\$ 3,695,710	\$ 184,035

CITY OF LITCHFIELD, MICHIGAN
RECONCILIATION OF ENTERPRISE FUNDS BALANCE SHEET
WITH THE STATEMENT OF NET ASSETS
YEAR ENDED JUNE 30, 2006

ENTERPRISE FUND NET ASSETS	\$ 2,770,741
Amounts reported for business activities in the statement of net assets are different because:	
Internal Service Funds are also included as business activities to the extent of activity occurring between Enterprise Funds and the Internal Service Fund	<u>34,215</u>
NET ASSETS OF BUSINESS-TYPE ACTIVITIES	<u><u>\$ 2,804,956</u></u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

PROPRIETARY FUNDS

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2006

	<u>ENTERPRISE FUNDS</u>	
	<u>MAJOR FUNDS</u>	
	<u>SEWER</u>	<u>WATER</u>
OPERATING REVENUES		
Charges for services	<u>\$ 104,383</u>	<u>\$ 163,116</u>
OPERATING EXPENSES		
General operations and maintenance	\$ 80,203	\$ 95,803
Depreciation	<u>97,964</u>	<u>52,597</u>
TOTAL OPERATING EXPENSES	<u>\$ 178,167</u>	<u>\$ 148,400</u>
OPERATING INCOME (LOSS)	<u>\$ (73,784)</u>	<u>\$ 14,716</u>
NON-OPERATING REVENUES (EXPENSES)		
Interest income	\$ 46,306	\$ 13,620
Interest expense	(20,025)	
Contributions	150,000	
Wellhead protection grant		<u>11,582</u>
TOTAL NET NON-OPERATING REVENUES	<u>\$ 176,281</u>	<u>\$ 25,202</u>
INCOME BEFORE OPERATING TRANSFERS	<u>\$ 102,497</u>	<u>\$ 39,918</u>
OPERATING TRANSFERS		
Operating transfers in	\$	\$ 200
Operating transfers out	<u>(28,000)</u>	<u>(17,000)</u>
TOTAL NET OPERATING TRANSFERS	<u>\$ (28,000)</u>	<u>\$ (16,800)</u>
NET INCOME	<u>\$ 74,497</u>	<u>\$ 23,118</u>
TOTAL NET ASSETS - BEGINNING OF YEAR	<u>1,415,011</u>	<u>1,252,505</u>
TOTAL NET ASSETS - END OF YEAR	<u><u>\$ 1,489,508</u></u>	<u><u>\$ 1,275,623</u></u>

See accompanying notes to the basic financial statements.

<u>ENTERPRISE FUNDS</u>		<u>INTERNAL SERVICE FUND</u>
<u>NON- MAJOR FUND</u>		
<u>REFUSE</u>	<u>TOTAL</u>	<u>EQUIPMENT</u>
<u>\$ 50,882</u>	<u>\$ 318,381</u>	<u>\$ 39,040</u>
<u>\$ 45,930</u>	<u>\$ 221,936</u>	<u>\$ 34,899</u>
	<u>150,561</u>	<u>13,355</u>
<u>\$ 45,930</u>	<u>\$ 372,497</u>	<u>\$ 48,254</u>
<u>\$ 4,952</u>	<u>\$ (54,116)</u>	<u>\$ (9,214)</u>
<u>\$ 9</u>	<u>\$ 59,935</u>	<u>\$ 1,843</u>
	<u>(20,025)</u>	
	<u>150,000</u>	<u>17,000</u>
	<u>11,582</u>	
<u>\$ 9</u>	<u>\$ 201,492</u>	<u>\$ 18,843</u>
<u>\$ 4,961</u>	<u>\$ 147,376</u>	<u>\$ 9,629</u>
<u>\$ (4,500)</u>	<u>\$ 200</u>	
	<u>(49,500)</u>	<u>(6,000)</u>
<u>\$ (4,500)</u>	<u>\$ (49,300)</u>	<u>\$ (6,000)</u>
<u>\$ 461</u>	<u>\$ 98,076</u>	<u>\$ 3,629</u>
<u>5,149</u>	<u>2,672,665</u>	<u>179,568</u>
<u>\$ 5,610</u>	<u>\$ 2,770,741</u>	<u>\$ 183,197</u>

CITY OF LITCHFIELD, MICHIGAN

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENSES, AND CHANGES
IN NET ASSETS TO THE STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2006

NET CHANGE IN NET ASSETS - TOTAL ENTERPRISE FUNDS	\$ 98,076
Amounts reported for business activities in the statement of activities are different because:	
Internal Service Funds are also included as business activities to the extent of activity occurring between Enterprise Funds and the Internal Service Fund	<u>1,270</u>
CHANGE IN NET ASSETS OF BUSINESS ACTIVITIES	<u>\$ 99,346</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN

PROPRIETARY FUNDS

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2006

	ENTERPRISE FUNDS	
	MAJOR FUND	
	SEWER	WATER
CASH FLOWS FROM OPERATING ACTIVITIES	\$ 105,878	\$ 164,824
Cash receipts from customers		
Cash receipts for interfund services provided	(27,773)	(35,510)
Payments to employees	(44,969)	(52,252)
Payments to suppliers	(6,558)	(7,403)
Payments to interfund services provided		
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 26,578	\$ 69,659
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	\$	\$ 11,582
Wellhead Protection Grant proceeds	150,000	
Contribution from component unit		200
Transfer from other funds	(28,000)	(17,000)
Transfer to other funds		
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	\$ 122,000	\$ (5,218)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	\$	\$
Interest paid on capital debt	(20,600)	
Principal paid on capital debt	(115,000)	
Purchase of capital assets		
NET CASH (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	\$ (135,600)	\$
CASH FLOWS FROM INVESTING ACTIVITIES	\$ 33,048	\$ 11,377
Interest		
NET CHANGE IN CASH	\$ 46,026	\$ 75,818
CASH - BEGINNING OF YEAR	978,571	329,899
CASH - END OF YEAR	\$ 1,024,597	\$ 405,717
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	\$	\$
Operating income (loss)	(73,784)	14,716
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	\$ 97,964	\$ 52,597
Restatement of beginning net assets		
(Increase) decrease in:		
Accounts receivable	1,495	1,708
Increase (decrease) in:		
Accrued liabilities	72	(408)
Accounts payable	831	1,046
Total Adjustments	\$ 100,362	\$ 54,943
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 26,578	\$ 69,659

See accompanying notes to the basic financial statements.

ENTERPRISE FUNDS		INTERNAL SERVICE FUND
NONMAJOR FUND		
REFUSE	TOTAL	EQUIPMENT
\$ 52,165	\$ 322,867	\$
(2,117)	(65,400)	39,040
(43,599)	(140,820)	(13,482)
	(13,961)	(20,579)
<u>\$ 6,449</u>	<u>\$ 102,686</u>	<u>\$ 4,979</u>
\$	\$ 11,582	\$
	150,000	17,000
	200	
(4,500)	(49,500)	(6,000)
<u>\$ (4,500)</u>	<u>\$ 112,282</u>	<u>\$ 11,000</u>
\$	\$ (20,600)	\$
	(115,000)	
		(16,526)
<u>\$</u>	<u>\$ (135,600)</u>	<u>\$ (16,526)</u>
\$ 9	\$ 44,434	\$ 1,670
\$ 1,958	\$ 123,802	\$ 1,123
1,087	1,309,557	76,143
<u>\$ 3,045</u>	<u>\$ 1,433,359</u>	<u>\$ 77,266</u>
\$ 4,952	\$ (54,116)	\$ (9,214)
\$	\$ 150,561	\$ 13,355
1,283	4,486	
	(336)	650
214	2,091	188
<u>\$ 1,497</u>	<u>\$ 156,802</u>	<u>\$ 14,193</u>
<u>\$ 6,449</u>	<u>\$ 102,686</u>	<u>\$ 4,979</u>

CITY OF LITCHFIELD, MICHIGAN
FIDUCIARY FUNDS
STATEMENT OF ASSETS AND LIABILITIES
JUNE 30, 2006

	<u>AGENCY FUND</u>
	<u>TAX COLLECTION FUND</u>
ASSETS	
Cash	<u>\$ 64,911</u>
LIABILITIES	
Due to other governmental units	<u>\$ 64,911</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Litchfield, Michigan conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies:

FINANCIAL REPORTING ENTITY

On June 1, 1970, the City of Litchfield, Michigan (the "City") adopted the Home Rule Charter. The City operates under a Council-Manager form of government and provides the following services as authorized by its charter: Public Safety (Police and Fire), Highways and Streets, Sanitation, Health, Recreation, Public, Improvements, Planning and Zoning, and General Administrative Services.

As required by generally accepted accounting principles, the financial statements of the reporting entity include those of the City (the primary government) and its component units. The component units discussed below are included in the City's reporting entity because of the significance of its operational or financial relationship with the City.

In conformity with generally accepted accounting principles, the financial statements of the component units have been included in the financial reporting entity as discretely presented component units.

Discretely Presented Component Units - The component unit columns in the basic financial statements include the financial data of the City's component units. The units are reported in a separate column to emphasize they are legally separate from the City.

Tax Increment Finance Authority (TIFA) - The Authority is governed by a separate board appointed by the City Council to promote economic growth in the City of Litchfield.

Downtown Development Authority - The Authority is governed by a separate board appointed by the City Council to formulate plans for design, promotion and organization, and economic restructuring of the City's downtown area.

Brownsfield Redevelopment Authority (BRA) - The Authority was established under the authority contained in Act 381, of the Michigan Public Acts of 1996, as amended. The Authority is governed by a separate board appointed by the City Council to facilitate the implementation of plans relating to the identification and treatment of environmentally distressed areas so as to promote revitalization in the City of Litchfield.

The basic financial statements do not include financial data of the Brownsfield Redevelopment Authority since it did not have any financial transactions during the year ended June 30, 2006.

Copies of the TIFA and DDA financial statements may be obtained at the City offices located at 221 Jonesville Street, Litchfield, Michigan 49252.

Joint Venture – Discussed at Note 2.

CITY OF LITCHFIELD, MICHIGAN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ECONOMIC DEPENDENCY

The City is economically dependent on the State of Michigan for state shared revenues. Absent allocations from the State, the City's operating results would report expenditures exceeding revenues in its General, Major Street, and Local Street Funds. Furthermore, the aforementioned funds would be in a deficit position within a two year period continuing the services the City currently offers.

GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The government-wide financial statements report information on all of the non-fiduciary activities of the primary government and its component units. The effect of inter-fund activity has been removed from these statements. Governmental activities are normally supported by taxes and intergovernmental revenues. Business-type activities rely on user fees and charges.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenue includes (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes, intergovernmental payments, and other items not included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental and proprietary funds are reported as separate columns in the fund financial statements; remaining funds are reported in the aggregate as non-major funds.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

When expenses are incurred for purposes for which both restricted and unrestricted net assets are available, restricted net assets are used prior to unrestricted net assets.

Governmental Funds

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures related to compensated absences, and claims and judgments are recorded only when payment is due.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL
STATEMENT PRESENTATION (CONTINUED)

Revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the fiscal period. Major revenue types for which receivables are recorded on the current accounting period's balance sheet include property taxes and State-shared revenues. All other revenue items are considered to be available only when cash is received by the City.

The City reports the following major governmental funds:

The *General Fund* is the general operating fund of the City. It is used to account for all financial resources of the general government, except those required to be accounted for in another fund.

The *Major and Local Street Funds* are Special Revenue Funds that account for revenue received from gasoline tax through the State of Michigan under Act 51. Expenditures of these funds include the maintenance of major and local streets, and roadway improvements.

The *Recreation Fund* is a Special Revenue Fund that accounts for resources that are expended on recreation activities carried out by the City. Revenue is primarily comprised of public and private donations, grants, and service charges.

Proprietary Funds

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the proprietary funds relates to charges to customers for services. Operating expenses for proprietary funds include the cost of services, administrative expenses, and depreciation of capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The City maintains the two proprietary fund types, enterprise and internal service funds.

Enterprise Funds are used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

The City reports the following major enterprise funds:

The *Water and Sewer Funds* account for the activities of the water distribution and sewage collection systems.

Additionally, the City reports one non-major Enterprise Fund, the Refuse Fund, which accounts for solid waste disposal billings and operating expenses.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE I: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL
STATEMENT PRESENTATION (CONCLUDED)

The *Internal Service Fund* accounts for shared machinery and equipment purchases and maintenance provided to other departments of the City on a cost reimbursement basis. This fund accounted for 35% and 65% of its activity with business-type and governmental activities, respectively. As a result, the assets and equity were reported in governmental activities and the net profit was allocated on a pro rata basis, based on the aforementioned percentages, to each of the activities. Business-type and governmental activities reported net profit of \$1,270 and \$2,359, respectively, for a total net profit of \$3,629. Therefore, the Internal Service Fund's net assets in the total amount of \$183,197 is reported in the business-type and governmental activities in the amounts of \$34,215 and \$148,982, respectively.

Fiduciary Funds (Not included in government-wide statements)

Fiduciary Funds are used to account for assets held in a trustee or agency capacity for others and therefore are not available to support City operations. Agency Funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. Agency funds are not included in the government-wide statements. The City presently collects and distributes property taxes on behalf of and to other local units of government.

General Information

Private-sector standards of accounting issued prior to December 1, 1989, are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this rule are charges between the City's water and sewer function and various other functions of the City. Elimination of these charges would distort costs and program revenues reported for the various functions concerned.

BANK DEPOSITS

Cash includes cash on hand, demand deposits, savings, certificate of deposits and municipal mutual funds that are highly liquid.

RECEIVABLES AND PAYABLES

Outstanding balances between funds are reported as "due to/from other funds." Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances." All trade and property tax receivables are reported at their net realizable values.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CAPITAL ASSETS

Capital assets that include land, buildings, improvements, equipment and vehicles are reported in the government-wide financial statements. The City defines capital assets as assets with an initial individual cost of more than \$2,000 and an estimated useful life in excess of 2 years. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Costs of normal repair and maintenance that do not add to the value or materially extend assets life are not capitalized but rather expensed in the period incurred.

The City has elected under Governmental Accounting Standards Board Statement No. 34 not to report infrastructure retrospectively. Newly acquired or constructed infrastructure will be capitalized and depreciated over their useful lives. There were no additions to infrastructure during the year.

Buildings, improvements, equipment and vehicles are depreciated using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Buildings	50
Improvements	10 - 20
Equipment	3 - 20
Vehicles	3 - 5

COMPENSATED ABSENCES

It is the City's policy to permit employees to accumulate earned but unused sick and vacation leave time. A total of 5 to 25 days vacation and 6 days of sick leave per year may be accumulated by each employee. Employees are allowed to accumulate and carryover ten vacation days to the following year with management approval. Otherwise vacation time not used is forfeited.

Furthermore, employees are allowed to accumulate no more than sixty days of sick leave time. Upon termination of employment, if an employee has five consecutive years or more of employment service the employee will be paid one-fourth of their accumulated unused sick leave time. Employees with ten consecutive years or more of employment service will be paid one-half of their accumulated unused sick leave time upon termination. Upon retirement, an employee will receive pay at their regular hourly rate for a maximum thirty days of accumulated unused sick leave time.

During the year the net increase in compensated absences was \$6,050 leaving an ending balance of \$43,210.

CITY OF LITCHFIELD, MICHIGAN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

LONG-TERM OBLIGATIONS

In the government-wide financial statements and the proprietary fund types reported in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. If applicable, bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Issuance costs are reported as debt service expenditures.

FUND EQUITY

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

PROPERTY TAX

The City of Litchfield, Michigan bills and collects property taxes and distributes them to other local units of government. Properties are assessed as of December 31, and the related real property taxes are levied and become payable on July 1 of the following year for summer taxes and December 1 for winter taxes. Summer and winter taxes are due without penalty if paid by September 14 and February 14, respectively. Delinquent taxes are turned over to the County and added to the County tax roll. The County remits all of the City's uncollected delinquent real property tax to the City by June 30. Uncollected personal property taxes are not accrued because the date of collection is uncertain.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

ENCUMBRANCE ACCOUNTING

Encumbrances for goods and services are documented by requisitions or contracts. Appropriations lapse at June 30 and any encumbrances outstanding at that time are to be either canceled or appropriately provided for in the subsequent year's budget. There were no outstanding encumbrances at June 30, 2006.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)

BUDGETS AND BUDGETARY ACCOUNTING

The City's procedures in establishing the budgetary data reflected in the financial statements are as follows:

1. The City Manager submits to the City Council a proposed operating budget for the fiscal year. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally enacted through passage of a resolution.
4. The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that change the total expenditures of any fund must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device during the year for the General Fund and Special Revenue Funds.
6. Budgets for the General and Special Revenue Funds are adopted on a basis consistent with generally accepted accounting principles, which is the modified accrual basis used to reflect actual results, and consist only of those amounts contained in the formal budget approved or as amended by the City Council. The General Fund budget is adopted at the department level and all other funds are adopted at the fund level.

NOTE 2: JOINT VENTURE

The City participates with the Litchfield Township in the Litchfield Fire Department (the "Department"), a joint venture pursuant to an agreement entered into between the two parties. In accordance to the provisions of Governmental Accounting Standards Board No. 14 the joint venture results from the on going financial responsibility of the Department's operations agreed to by the aforementioned municipalities pursuant to the contractual agreement. A seven member Board of Directors comprised of two members of the City of Litchfield Council, two members of Litchfield Township Board, one member of Scipio Township and Butler Township Boards, and one member from the community at large govern the Department.

Either the City or Litchfield Township has the power to terminate the joint venture. However, notice of termination must be given six months prior to the Department's fiscal year end. Upon termination, all property of the Litchfield Fire Department will be liquidated and any outstanding indebtedness will be paid. The proceeds then remaining will be divided equally between the City of Litchfield, Michigan and the Litchfield Township.

The Department is funded by fire contracts with local townships and equal contributions made by the City of Litchfield, Michigan and the Litchfield Township. The Fire Department reported expenditures in excess of revenues in the amount of \$18,800 in its year end June 30, 2006 general ledger. The City of Litchfield, Michigan reported \$9,900 (fifty-percent) of the expenditures over revenues in its government-wide financial statements in governmental activities. The City's investment in the joint venture is reported in the statement of net assets under governmental activities in the amount of \$30,590.

CITY OF LITCHFIELD, MICHIGAN

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 2: JOINT VENTURE (CONCLUDED)

At year end June 30, 2006 the Department does not have title to any real property or rescue vehicles. The City of Litchfield, Michigan and the Litchfield Township have title, either jointly or individually, to all fire rescue vehicles used in the Department's operations. Additionally, the City and the Township are mutually obligated in a capital lease agreement to finance a rescue vehicle; see Note 7.

Copies of the Fire Department's financial statements may be obtained at the City of Litchfield, Michigan offices.

NOTE 3: DEPOSITS AND INVESTMENTS

Michigan Compiled Laws, Section 129.91, authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions that at the time of purchase are rated as investment grade by not less than one standard rating service; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

At year end, deposits and investments were comprised of the following:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Agency Fund</u>	<u>Total Primary Government</u>	<u>Component Units</u>
Cash	\$ 609,515	\$ 1,359,931	\$ 64,911	\$ 2,034,357	\$ 1,215,750
Cash - restricted	<u>7,517</u>	<u>73,428</u>	<u> </u>	<u>80,945</u>	<u> </u>
	<u>\$ 617,032</u>	<u>\$ 1,433,359</u>	<u>\$ 64,911</u>	<u>\$ 2,115,302</u>	<u>\$ 1,215,750</u>
Investments	\$ <u> </u>	\$ <u> </u>	\$ <u> </u>	\$ <u> </u>	\$ 607,651
Total	<u>\$ 617,032</u>	<u>\$ 1,433,359</u>	<u>\$ 64,911</u>	<u>\$ 2,115,302</u>	<u>\$ 1,823,401</u>

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 3: CASH AND INVESTMENTS (CONCLUDED)

The breakdown between cash and investments for the City and component units are as follows:

	<u>Primary Government</u>	<u>Component Units</u>
Cash (checking accounts, savings accounts and Certificates of Deposits)	\$ 2,115,202	\$ 1,215,750
Investment in money market fund		607,651
Petty cash	<u>100</u>	
Total	<u>\$ 2,115,302</u>	<u>\$ 1,823,401</u>

Deposits

The City and its component unit's deposits were reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) at \$3,919,697. Of that amount, \$665,852 was covered by federal depository insurance and the remainder was uninsured and uncollateralized.

The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the City evaluates each financial institution with which it deposits City funds and assesses the level of risk of each institution; only those with an acceptable estimated risk level are used as depositories.

Investments

Investments are normally categorized to give an indication of the level of risk assumed by the City. As of June 30, 2006, the City's component unit, the Tax Increment Financing Authority, held investments in a money market fund, totaling \$607,651, which was rated AAA by Standard & Poor's rating service. Additionally, there is no custodial risk because the fund is not evidenced by securities that exist in physical or book entry form.

The investment policy adopted by the City Council is in accordance with Public Act 196 of 1997.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 4: CAPITAL ASSETS

Capital asset activity of the primary government was as follows:

	Balance - July 1, 2005	Additions	Disposals	Balance June 30, 2006
<u>Governmental Activities</u>				
Capital assets not being depreciated:				
Land	\$ 866,073	\$	\$	\$ 866,073
Capital assets being depreciated:				
Buildings and improvements	316,082			316,082
Equipment	520,328	26,253		546,581
Vehicles	63,080	6,000	20,040	49,040
Technology	24,954			24,954
Pool	39,962			39,962
Subtotal	<u>\$ 1,830,479</u>	<u>\$ 32,253</u>	<u>\$ 20,040</u>	<u>\$ 1,842,692</u>
Accumulated depreciation:				
Buildings and improvements	\$ 188,864	\$ 5,298	\$	\$ 194,162
Equipment	255,237	31,989		287,226
Vehicles	55,413	9,667	20,040	45,040
Technology	11,124	5,258		16,382
Pool		2,997		2,997
Subtotal	<u>\$ 510,638</u>	<u>\$ 55,209</u>	<u>\$ 20,040</u>	<u>\$ 545,807</u>
Net Capital Assets	<u>\$ 1,319,841</u>	<u>\$ (22,956)</u>	<u>\$</u>	<u>\$ 1,296,885</u>

Governmental activities depreciation expense of \$55,209 is comprised of unallocated and allocated depreciation expense of \$41,854 and \$13,355, respectively. Allocated depreciation expense is calculated on capital assets maintained in the Internal Service Fund. See significant accounting policies regarding Internal Service Funds.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 4: CAPITAL ASSETS (CONCLUDED)

	Balance July 1, 2005	Additions	Disposals	Balance June 30, 2006
<u>Business-type Activities</u>				
Capital assets not being depreciated:				
Land	\$ 265,571	\$	\$	\$ 265,571
Capital assets being depreciated:				
Water and sewer distribution system	5,715,156			5,715,156
Vehicles	22,900			22,900
Subtotal	<u>\$ 6,003,627</u>	<u>\$</u>	<u>\$</u>	<u>\$ 6,003,627</u>
Accumulated depreciation:				
Water and sewer distribution system	\$ 3,624,391	\$ 145,981	\$	\$ 3,770,372
Vehicles	7,252	4,580		11,832
Subtotal	<u>\$ 3,631,643</u>	<u>\$ 150,561</u>	<u>\$</u>	<u>\$ 3,782,204</u>
Net Capital Assets	<u>\$ 2,371,984</u>	<u>\$ (150,561)</u>	<u>\$</u>	<u>\$ 2,221,423</u>

Depreciation expense charged to business-type activities was \$150,561.

NOTE 5: NOTE RECEIVABLE

In January 1997 the City entered into an agreement to sell land to a local industrial company in the amount of \$50,000. The terms of the agreement require the local company to pay \$5,000 annually, including interest at 10%. However, if the local company achieves employment levels annually as stated in the agreement the City will forgive the annual principal payments, including interest, each year employment levels are met.

During the year the City forgave principal payments of \$5,000. At June 30, 2006 the outstanding balance due from the local company was \$7,500. Following are future principal maturities:

<u>June 30</u>	<u>Amount</u>
2007	\$ 5,000
2008	<u>2,500</u>
	<u>\$ 7,500</u>

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 6: OPERATING LEASE

In fiscal year ended June 30, 2005 the City entered into a lease agreement to lease City owned farmland to a local individual. The terms of the lease require the individual to pay the City \$5,385 annually, through April 1, 2009.

Future minimum lease payments to be received from the individual are as follows:

<u>June 30</u>	<u>Amount</u>
2007	\$ 5,385
2008	5,385
2009	<u>5,385</u>
Total	<u>\$ 16,155</u>

NOTE 7: LONG-TERM DEBT

Long-term debt at June 30, 2006 is comprised of the following:

Revenue Bonds, \$2,190,000 Michigan State Revolving Loan due in annual installments of \$25,000 to \$135,000 at an annual interest rate of 2% through April 1, 2014	<u>\$ 915,000</u>
Less: current portion of long-term debt	<u>\$ 120,000</u>
TOTAL LONG-TERM DEBT	<u>\$ 795,000</u>

The following is a summary of changes in long-term debt:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006
<u>Governmental Activities</u>				
Capital lease - Emergency One	<u>\$ 16,611</u>	<u>\$</u>	<u>\$ 16,611</u>	<u>\$</u>
<u>Business-type Activities</u>				
Revenue bonds	<u>\$ 1,030,000</u>	<u>\$</u>	<u>\$ 115,000</u>	<u>\$ 915,000</u>

Cash paid for interest during the year totaled \$20,600. Interest expense incurred during the year totaled \$20,995 and is reported as a direct function expense.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006

NOTE 7: LONG-TERM DEBT (CONCLUDED)

The following is a schedule of principal and interest maturities:

	Business-type Activities		
	Principal	Interest	Total
2007	\$ 120,000	\$ 18,300	\$ 138,300
2008	120,000	15,900	135,900
2009	125,000	13,500	138,500
2010	125,000	11,000	136,000
2011	130,000	8,500	138,500
2012-2014	<u>295,000</u>	<u>9,800</u>	<u>304,800</u>
	<u>\$ 915,000</u>	<u>\$ 77,000</u>	<u>\$ 992,000</u>

NOTE 8: RETIREMENT PLAN

During the year, City Council approved establishing a retirement account with Municipal Employees' Retirement System of Michigan (MERS) an agent multiple employer plan administered by the Retirement Board of MERS. Furthermore, City Council approved the dissolution of its deferred compensation plan that was established in accordance with Internal Revenue Code Section 457. The assets maintained in the deferred compensation plan comprised account balances of retirees and current employees. As a result assets were distributed to retirees for their respective account balances and the remaining assets representing current employees were transferred to a MERS account. As of June 30, 2006 the City had not received an actuarial valuation based on the assets transferred into the plan.

The MERS Plan provides retirement and disability benefits, annual cost of living adjustments and death benefits to Plan members and beneficiaries. The MERS Retirement Board establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 447 N. Canal Road, Lansing, Michigan 48917, or by calling (800) 767-6377.

Actuarial information pertaining to the City's Plan will be reported in future periods as valuations are provided.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 9: EXPENDITURES OVER BUDGET AND FUND DEFICIT

P.A. 621 of 1978 Section 18, as amended, provides that a local unit shall not incur expenditures in excess of the amount appropriated. The approved Recreation Fund budget of the City was adopted at the fund level. During the year ended June 30, 2006, the City incurred expenditures in the fund, which were in excess of the amended budget as follows:

	<u>Final Budget</u>	<u>Actual</u>	<u>Unfavorable Variance</u>
General Fund	\$ 685,318	\$ 694,749	\$ 9,431
Recreation Fund	\$ 62,869	\$ 68,867	\$ 5,998

Additionally, P.A. 275 of 1980, provides that a local unit shall not carry a deficit fund balance in any of its funds. At year ended June 30, 2006 the City's Recreation Fund ended the year with a deficit fund balance in the amount of \$3,072. Management plans to eliminate the deficit by appropriating funds from the General Fund to the Recreation Fund in an amount equal to the deficit.

NOTE 10: FUND EQUITIES

Reserved, designated and undesignated fund balances and net assets at June 30, 2006 were as follows:

	<u>Restricted/ Reserved</u>	<u>Designated</u>
Governmental Activities:		
<u>Fund Balance/Net Assets</u>		
General Fund		
Police cars	\$	\$ 24,000
Police training – Act 302	1,217	
Personal property tax audit	6,300	
Fire truck		21,100
Parks		911
	<u>\$ 7,517</u>	<u>\$ 46,011</u>
Business-type Activities:		
<u>Net Assets</u>		
Sewer Fund		
Bond repayment	\$ 73,428	\$

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 11: OPERATING TRANSFERS

Interfund transfers for the current year are as follows:

<u>General Fund Activity</u>		
Transfers in to:	Transfers (out) of:	
General Fund	Recreation Fund	\$ 1,000
General Fund	Major Street Fund	8,000
General Fund	Local Street Fund	2,000
General Fund	Refuse Fund	4,500
General Fund	Sewer Fund	28,000
General Fund	Water Fund	17,000
General Fund	Equipment Fund	<u>6,000</u>
Total		<u>\$ 66,500</u>
Recreation Fund	General Fund	<u>\$ 42,983</u>
<u>Recreation Fund Activity</u>		
Transfers in to:	Transfers (out) of:	
Water Fund	Recreation Fund	<u>\$ 200</u>
<u>Local Street Fund Activity</u>		
Transfers in to:	Transfers (out) of:	
Local Street Fund	Major Street Fund	<u>\$ 8,251</u>

Transfers from the General Fund to other funds are to support the operations of those funds. Transfers from other funds to the General Fund are reimbursements for administration support.

Transfer from the Recreation Fund to the Water Fund is reimbursement for water usage in the City's swimming pool.

Transfer from Major Street Fund to Local Street Fund for local street maintenance.

NOTE 12: INTERFUND RECEIVABLES AND PAYABLES

The following are interfund receivables (due from) and interfund payables (due to) reported in fund activities:

<u>Due From -</u>	<u>Due To -</u>	
<u>Collectible By:</u>	<u>Payable By:</u>	
Local Street Fund	Major Street Fund	<u>\$ 2,129</u>
For local street maintenance		

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2006

NOTE 13: COMPONENT UNIT CONTRIBUTIONS

During the year the City of Litchfield's Tax Increment Financing Authority (TIFA) contributed \$220,300 to the City's operations to support the following activities:

<u>General Fund</u>	
Reimburse City for administration cost	\$ 28,300
Fire support to the industrial park	<u>25,000</u>
	<u>\$ 53,300</u>
 <u>Internal Service Equipment Fund</u>	
Capital support for equipment replacement	<u>\$ 17,000</u>
 <u>Sewer Fund</u>	
Support towards bond obligation	<u>\$ 150,000</u>

NOTE 14: RISK MANAGEMENT

The City of Litchfield, Michigan is exposed to various risks of loss related to property loss, torts, errors, and omissions, employee injuries, unemployment benefits, as well as medical and workmen's compensation benefits provided to employees. The City of Litchfield, Michigan has purchased commercial insurance for general liability on buildings and property, equipment damage and theft, employee theft, and limited tort claims for specific City of Litchfield, Michigan facilities or events.

The City participates in the Michigan Municipal League Workers Compensation Fund, a public risk pool established to operate a common risk management and insurance program for municipalities. The City pays premiums to the Fund for its workers' disability compensation insurance coverage. The agreement for formation of the fund provides that the Fund will be self-sustaining through member premiums.

The City continues to carry commercial insurance for all other risks of loss, including employee health and accident insurance. Settled claims for the commercial insurance have not exceeded the amount of coverage in any of the past three years. There was no reduction in coverage obtained through commercial insurance during the past year.

NOTE 15: CONTINGENCIES

Under the terms of various Federal and State grants and regulatory requirements, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants and requirements. Such audits could lead to reimbursement to the grantor or regulatory agencies. However, City management does not believe such disallowances, if any, would be material to the financial position of the City.

As is the case with other entities, the City faces exposure from potential claims and legal proceedings involving environmental matters. No such claims or proceedings have been asserted as of June 30, 2006.

CITY OF LITCHFIELD, MICHIGAN
NOTES TO FINANCIAL STATEMENTS (CONCLUDED)

JUNE 30, 2006

NOTE 16: SUBSEQUENT EVENT

In July 2006 the City acquired equipment totaling \$21,990. In August 2006, City Council approved the purchase of a new electronic utility meter reading system and new meters totaling \$131,650.

NOTE 17: PRIOR PERIOD ADJUSTMENT

At June 30, 2005 the City reported its interest in the Litchfield Fire Department Joint Venture, with Litchfield Township, from un-audited information provided by the Fire Department. Un-audited information was reported in the City's financial statements in order to comply with State of Michigan Department of Treasury's filing deadline for local units of government. As a result the auditor's opinion was qualified to that effect. In March 2006 the auditors of the Litchfield Fire Department issued their report on the Fire Departments audited financial statements. Those financial statements reported a change in net assets in the amount of \$46,688 of which fifty percent, or \$23,344, represented the City's interest. The audited change in net assets was \$14,212 higher than what the City reported in its June 30, 2005 financial statements. Therefore, at year ended June 30, 2006, the City reported a prior period adjustment in the amount of \$14,212 to its governmental activities net assets.

REQUIRED SUPPLEMENTAL INFORMATION

CITY OF LITCHFIELD, MICHIGAN
REQUIRED SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
YEAR ENDED JUNE 30, 2006

	ORIGINAL BUDGET	FINAL AMENDED BUDGET	ACTUAL	FINAL BUDGET TO ACTUAL
REVENUE				
Taxes	\$ 366,075	\$ 369,076	\$ 366,798	\$ (2,278)
State shared revenues	139,198	138,614	138,345	(269)
State grant			6,792	6,792
Charges for services	57,275	24,915	25,232	317
Licenses and permits	8,687	8,687	9,503	816
Fines, fees, and forfeits	3,000	1,716	1,781	65
Component unit contributions	47,000	47,000	53,300	6,300
Interest	16,000	15,000	17,990	2,990
Lease revenue	5,385	5,385	5,385	
Other	2,000	5,282	5,884	602
TOTAL REVENUES	<u>\$ 644,620</u>	<u>\$ 615,675</u>	<u>\$ 631,010</u>	<u>\$ 15,335</u>
EXPENDITURES				
General government	\$ 290,043	\$ 303,436	\$ 308,827	\$ (5,391)
Public safety	269,171	266,360	267,548	(1,188)
Public works	102,456	69,338	66,060	3,278
Parks	25,138	21,064	20,421	643
Debt service:				
Principal	16,611	16,611	16,611	
Interest	970	970	970	
Capital outlay	1,539	7,539	14,312	(6,773)
TOTAL EXPENDITURES	<u>\$ 705,928</u>	<u>\$ 685,318</u>	<u>\$ 694,749</u>	<u>\$ (9,431)</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>\$ (61,308)</u>	<u>\$ (69,643)</u>	<u>\$ (63,739)</u>	<u>\$ 5,904</u>
OTHER FINANCIAL SOURCES (USES)				
Operating transfers in	\$ 58,000	\$ 66,500	\$ 66,500	\$
Operating transfers (out)	(25,419)	(46,486)	(42,983)	3,503
TOTAL OTHER FINANCING SOURCES	<u>\$ 32,581</u>	<u>\$ 20,014</u>	<u>\$ 23,517</u>	<u>\$ 3,503</u>
NET CHANGE IN FUND BALANCE	<u>\$ (28,727)</u>	<u>\$ (49,629)</u>	<u>\$ (40,222)</u>	<u>\$ 9,407</u>
FUND BALANCE - BEGINNING OF YEAR	<u>282,288</u>	<u>282,288</u>	<u>282,288</u>	
FUND BALANCE - END OF YEAR	<u><u>\$ 253,561</u></u>	<u><u>\$ 232,659</u></u>	<u><u>\$ 242,066</u></u>	<u><u>\$ 9,407</u></u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN
REQUIRED SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE -
MAJOR SPECIAL REVENUE FUND -
MAJOR STREET

YEAR ENDED JUNE 30, 2006

	ORIGINAL BUDGET	FINAL AMENDED BUDGET	ACTUAL	FINAL BUDGET TO ACTUAL
REVENUE				
State shared revenue	\$ 5,367	\$ 5,367	\$ 5,367	\$
State gasoline tax revenue	88,848	86,518	81,868	(4,650)
State grant	5,102	5,102	5,168	66
Community contributions		2,210	2,440	230
Interest	1,300	5,500	8,596	3,096
TOTAL REVENUES	<u>\$ 100,617</u>	<u>\$ 104,697</u>	<u>\$ 103,439</u>	<u>\$ (1,258)</u>
EXPENDITURES				
Trunkline maintenance	\$ 10,741	\$ 9,652	\$ 3,572	\$ 6,080
Road maintenanc	27,146	24,914	18,430	6,484
Operating supplies	4,145	6,145	4,646	1,499
Employee benefits	10,663	9,508	8,009	1,499
TOTAL EXPENDITURES	<u>\$ 52,695</u>	<u>\$ 50,219</u>	<u>\$ 34,657</u>	<u>\$ 15,562</u>
REVENUES OVER EXPENDITURES	<u>\$ 47,922</u>	<u>\$ 54,478</u>	<u>\$ 68,782</u>	<u>\$ 14,304</u>
OTHER FINANCING SOURCES (USES)				
Operating transfers (out)	<u>\$ (6,000)</u>	<u>\$ (28,184)</u>	<u>\$ (16,251)</u>	<u>11,933</u>
NET CHANGE IN FUND BALANCE	\$ 41,922	\$ 26,294	\$ 52,531	\$ 26,237
FUND BALANCE - BEGINNING OF YEAR	<u>219,262</u>	<u>219,262</u>	<u>219,262</u>	
FUND BALANCE - END OF YEAR	<u><u>\$ 261,184</u></u>	<u><u>\$ 245,556</u></u>	<u><u>\$ 271,793</u></u>	<u><u>\$ 26,237</u></u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN
REQUIRED SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE -
MAJOR SPECIAL REVENUE FUND -
LOCAL STREET

YEAR ENDED JUNE 30, 2006

	ORIGINAL BUDGET	FINAL AMENDED BUDGET	ACTUAL	FINAL BUDGET TO ACTUAL
REVENUE				
State revenues	\$ 28,046	\$ 27,323	\$ 27,129	\$ (194)
Interest	387	387	1,175	788
TOTAL REVENUES	<u>\$ 28,433</u>	<u>\$ 27,710</u>	<u>\$ 28,304</u>	<u>\$ 594</u>
EXPENDITURES				
Road maintenance	\$ 30,512	\$ 33,821	\$ 20,271	\$ 13,550
Operating supplies	2,340	4,340	4,420	(80)
Employee benefits	7,953	7,733	7,735	(2)
TOTAL EXPENDITURES	<u>\$ 40,805</u>	<u>\$ 45,894</u>	<u>\$ 32,426</u>	<u>\$ 13,468</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>\$ (12,372)</u>	<u>\$ (18,184)</u>	<u>\$ (4,122)</u>	<u>\$ 14,062</u>
OTHER FINANCING SOURCES (USES)				
Operating transfers in	\$	\$ 20,184	\$ 8,251	\$ (11,933)
Operating transfers (out)	(2,000)	(2,000)	(2,000)	
TOTAL OTHER FINANCING SOURCES (USES)	<u>\$ (2,000)</u>	<u>\$ 18,184</u>	<u>\$ 6,251</u>	<u>\$ (11,933)</u>
NET CHANGE IN FUND BALANCE	\$ (14,372)	\$	\$ 2,129	\$ 2,129
FUND BALANCE - BEGINNING OF YEAR	38,968	38,968	38,968	
FUND BALANCE - END OF YEAR	<u>\$ 24,596</u>	<u>\$ 38,968</u>	<u>\$ 41,097</u>	<u>\$ 2,129</u>

See accompanying notes to the basic financial statements.

CITY OF LITCHFIELD, MICHIGAN
REQUIRED SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE
- MAJOR SPECIAL REVENUE FUND -
RECREATION

YEAR ENDED JUNE 30, 2006

	ORIGINAL BUDGET	FINAL AMENDED BUDGET	ACTUAL	FINAL TO ACTUAL
REVENUE				
Recreation	\$	\$ 509	\$ 509	\$
Pool	13,800	13,200	15,155	1,955
Basketball tournament			990	990
Summer ball	1,880	1,880	2,597	717
Circus		3,240	3,245	5
Ice skating rink		500	500	
TOTAL REVENUES	<u>\$ 15,680</u>	<u>\$ 19,329</u>	<u>\$ 22,996</u>	<u>\$ 3,667</u>
EXPENDITURES				
Pool	\$ 45,087	\$ 54,663	\$ 59,166	\$ (4,503)
Sweet corn days	832	2,641	2,636	5
Basketball tournament	500	500	342	158
Summer ball	2,398	2,398	3,888	(1,490)
Circus		1,950	2,118	(168)
Ice skating rink		717	717	
TOTAL EXPENDITURES	<u>\$ 48,817</u>	<u>\$ 62,869</u>	<u>\$ 68,867</u>	<u>\$ (5,998)</u>
REVENUES OVER EXPENDITURES	<u>\$ (33,137)</u>	<u>\$ (43,540)</u>	<u>\$ (45,871)</u>	<u>\$ (2,331)</u>
OTHER FINANCING SOURCES (USES)				
Operating transfers in	\$ 25,419	\$ 42,740	\$ 42,983	\$ 243
Operating transfers (out)	(1,200)	(1,200)	(1,200)	
TOTAL OTHER FINANCING (USES)	<u>\$ 24,219</u>	<u>\$ 41,540</u>	<u>\$ 41,783</u>	<u>\$ 243</u>
NET CHANGE IN FUND BALANCE	<u>\$ (8,918)</u>	<u>\$ (2,000)</u>	<u>\$ (4,088)</u>	<u>\$ (2,088)</u>
FUND BALANCE - BEGINNING OF YEAR	<u>1,016</u>	<u>1,016</u>	<u>1,016</u>	
FUND BALANCE - END OF YEAR	<u><u>\$ (7,902)</u></u>	<u><u>\$ (984)</u></u>	<u><u>\$ (3,072)</u></u>	<u><u>\$ (2,088)</u></u>

See accompany notes to the basic financial statements.

OTHER REPORTS



Osbourne, March, Condon & Co., P.C.

Certified Public Accountants

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GAO GOVERNMENT AUDITING STANDARDS REPORT

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND OTHER MATTERS ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the City Council
City of Litchfield
Litchfield, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Litchfield as of and for the year ended June 30, 2006, which collectively comprise the City of Litchfield's basic financial statements and have issued our report thereon dated October 5, 2006. We did not audit the financial statements of the Litchfield Fire Department, a joint venture between the City of Litchfield, Michigan and Litchfield Township, Michigan, which the financial statements reflect the City's total share of assets and revenues constituting one percent of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Litchfield Fire Department, a joint venture between the City of Litchfield and Litchfield Township, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Litchfield's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Litchfield's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

However, we noted matters involving the internal control over financial reporting that we have reported to management of City of Litchfield, Michigan, in a separate letter dated October 5, 2006.

This report is intended for the information of the City Council, management and the State of Michigan. However, this report is a matter of public records and its distribution is not limited.

Osbourne, March, Condon & Co P.C.

Certified Public Accountants

Hillsdale, Michigan
October 5, 2006



Osbourne, March, Condon & Co., P.C.

Certified Public Accountants

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October 5, 2006

City Council
City of Litchfield
Litchfield, Michigan

In planning and performing our audit of the financial statements of the City of Litchfield for the year ended June 30, 2006, we considered the City of Litchfield's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit, we became aware of a matter that is an opportunity for strengthening internal control and operating efficiency. The memorandum that accompanies this letter summarizes our comment and suggestion regarding this matter. This letter does not affect our report dated October 5, 2006, on the financial statements of the City of Litchfield.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with the City Manager, and we will be pleased to discuss it in further detail at your convenience, to perform any additional study of this matter, or to assist you in implementing the recommendation.

Osbourne, March, Condon & Co P.C.

Certified Public Accountants

EXPENDITURES OVER BUDGET AND FUND DEFICIT

P.A. 621 of 1978 Section 18, as amended, provides that a local unit shall not incur expenditures in excess of the amount appropriated. The approved Recreation Fund budget of the City was adopted at the fund level. During the year ended June 30, 2006, the City incurred expenditures in the fund, which were in excess of the amended budget as follows:

	<u>Final Budget</u>	<u>Unfavorable Actual</u>	<u>Variance</u>
General Fund	\$ <u>685,318</u>	\$ <u>694,749</u>	\$ <u>9,431</u>
Recreation Fund	\$ <u>62,869</u>	\$ <u>68,867</u>	\$ <u>5,998</u>

We encourage management propose budget amendments to City Council that take into consideration expenditures that may occur during the last week of June, to avoid actual expenditures exceeding the amended budget.

Additionally, P.A. 275 of 1980, provides that a local unit shall not carry a deficit fund balance in any of its funds. At year ended June 30, 2006 the City's Recreation Fund ended the year with a deficit fund balance in the amount of \$3,072. We recommend that management eliminate the deficit by appropriating funds from the General Fund to the Recreation Fund in an amount equal to the deficit.

INTERNAL CONTROLS

Effective in 2008 are stringent audit standards that the public accounting profession will be required to adhere to in conducting financial audits. These standards embrace many characteristics of Sarbanes-Oxley Legislation as it relates to documentation and testing of internal controls. Auditors of non-public companies and organizations, e.g., companies that do not publicly trade their securities, will be required to document and test controls, following similar standards as auditors of publicly trading companies. As you can imagine this will increase audit time and cost.

Historically, auditors have been required to give consideration to internal controls in all audits which require a certain level of documentation. However, the new standards require the documentation to occur at a much higher level. Organizations that rotate auditors on a defined cycle are exposed to paying for the documentation of their internal control system every time they change auditors. To limit these costs organizations should take it upon themselves to document their internal controls as prescribed by these standards.

We recommend the City of Litchfield begin this documentation process over the next twelve to eighteen months. The process should begin by identifying the various processes that need to be documented; e.g., cash receipting, cash disbursing, payroll disbursements, managing cash deposits, budgeting, capitalization of equipment, etc. Once the processes are identified each step in the process should be outlined, identifying the person performing the step, identify key internal controls in the process, whether the control is IT dependent, and determine whether the internal control is a preventive or detection control. These procedural outlines of the various processes will be used to create a final documentation of the systems in *internal control matrices*. These matrices will be retained by the City and utilized by independent auditors, management and City Council in their annual review of internal controls, and become part of the City's policies and procedures.